

General Information Letter: Foreign corporation whose income is exempt from federal taxation by treaty has no Illinois base income.

March 14, 2005

Dear:

This is in response to your letter dated January 25, 2005. Department rules require that the Department issue two types of letter rulings, namely, private letter rulings and general information letters. Department rules set forth the requirements for the issuance of private letter rulings and general information letters. See 2 Ill. Adm. Code § 1200. Although you have not specifically requested either type of ruling, the nature of your request and the information provided require that we respond with a general information letter. A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.ILtax.com.

Your letter states as follows:

We represent a foreign (non U.S.) corporation ("Corporation") which enters into supply contracts to sell products (food ingredients) to United States customers. Because its customers require timely delivery of the commodities, Corporation maintains an inventory of its products in the United States and leases space to store such inventory in public warehouses located in Illinois. This essentially is the only activity conducted by Corporation in Illinois.

Under a tax treaty with the United States, Corporation is permitted to take the position that these circumstances involving the warehousing of goods do not constitute the maintenance of a "permanent establishment" in the United States, with the result that it is not subject to federal taxation. Nevertheless, Corporation files a protective federal tax return which reflects no federal income or tax liability.

Illinois imposes a corporate net income tax at the rate of 7.3%. Under Section 203(b) of the Illinois Income Tax Act (35 ILCS 5/203), the computation of a corporation's net income subject to Illinois income tax begins with the corporation's federal taxable income. Various addition and subtraction modifications are then made under that section, and the resulting "base income" is allocated and apportioned under Article 3. If a taxpayer has zero taxable income because it is a foreign corporation with no permanent establishment, none of the addition modifications in Section 203(b)(2) would apply and it would have zero base income.

Because the computation of a corporation's net income subject to Illinois income tax begins with the corporation's federal taxable income, Corporation would, therefore, have no income for Illinois tax purposes, and thus, no state liability. However, under Section 502(a) of the Illinois Income Tax Act (35 ILCS 5/502), a corporation must file an Illinois income tax return if it has a liability or if it is qualified to do business in Illinois and is required to file a federal income tax return.

Based on the nature of the state corporate income tax, Illinois should use Corporation's zero federal taxable income as its tax base, with the result that it would have no Illinois taxable income or resulting tax liability and, presumably, no Illinois reporting requirement. We, therefore, seek definitive guidance from the Illinois Department of Revenue to verify our conclusions in the form of a letter ruling.

In the event the Department rules to the contrary or determines that Corporation has a reporting requirement notwithstanding that it has no federal taxable income, we request consideration under the Department's Voluntary Disclosure Program.

RULING

Section 201(a) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/201) imposes a tax, measured by "net income," upon every individual, corporation, trust and estate for the privilege of earning or receiving income in or as a resident of this State. Section 201(c) of the IITA imposes the Personal Property Tax Replacement Income Tax, also measured by "net income," on every corporation (including Subchapter S corporation), partnership and trust, for the privilege of earning or receiving income in or as a resident of this State. Illinois net income is defined at section 202 of the IITA as that portion of the taxpayer's "base income" allocable to Illinois. The starting point in calculating "base income" for purposes of section 203 is the taxpayer's taxable income for federal income tax purposes. In particular, section 203(e)(1) provides that for purposes of computing Illinois base income, a taxpayer's "taxable income" for the taxable year means the amount of taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code. In order to arrive at Illinois base income, the taxpayer's federal taxable income is modified in accordance with certain statutorily prescribed addition and subtraction amounts.

Section 502(a) of the IITA sets forth the requirements for filing Illinois income tax returns. Under this section, a corporation is required to file an Illinois income tax return if it incurs a liability for tax imposed under section 201 or is qualified to do business in Illinois and required to file a federal return.

Applying the above provisions in this case, where a foreign corporation is not subject to federal income tax (whether as the result of a treaty or otherwise), and therefore is not required to report federal taxable income on a federal return, such corporation is not liable for Illinois income tax under section 201. Because a foreign corporation in these circumstances does not have Illinois net income under section 202, there is no liability for tax under section 201. Further, since a federal income tax return is not required, no Illinois return is required under section 502.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department, please submit a request conforming to the requirements of 2 Ill. Adm. Code § 1200.110(b).

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)